

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

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**THE AMOUNT OF RENT DUE TO THE STATE FROM  
BAZAAR DEL MUNDO, INC., A CONCESSIONAIRE  
AT OLD TOWN SAN DIEGO STATE HISTORIC PARK,  
IS IN QUESTION**

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REPORT BY THE  
OFFICE OF THE AUDITOR GENERAL  
TO THE  
JOINT LEGISLATIVE AUDIT COMMITTEE

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THE AMOUNT OF RENT DUE TO THE STATE  
FROM BAZAAR DEL MUNDO, INC., A CONCESSIONAIRE  
AT OLD TOWN SAN DIEGO STATE HISTORIC PARK,  
IS IN QUESTION

APRIL 1982



# California Legislature

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April 7, 1982

The Honorable president pro Tempore of the Senate 111  
 The Honorable Speaker of the Assembly  
 The Honorable Members of the Senate and the  
 Assembly of the Legislature of California

Members of the Legislature:

Transmitted herewith is the Auditor General's report on Bazaar Del Mundo, Inc., a concessionaire at Old Town San Diego State Historic Park. The audit was requested by Assemblyman Douglas H. Bosco who, as Chairman of Ways and Means Subcommittee No. 3, had questions regarding the amount of rent due to the state from the concessionaire.

The report discloses that for the first 15 months of the contract (November 1971 through January 1973), the correct amount of rent was paid to the state. After January 1973, the amount due to the state is in question and can not be readily determined because of disagreements with the concessionaire over the terms of the contract regarding amortizing improvements, and the meaning of gross receipts as it applies to subleases. Employees of the Department of Parks and Recreation have attempted to resolve some of the differences by oral agreements.

In order to resolve these differences in a business-like way it is recommended that the Department of Parks and Recreation formally amend its contract with the concessionaire. Since the department has concessionaire contracts at many other locations, it should require its employees to refrain from oral agreements with concessionaires.

Respectfully submitted,

WALTER M. INGALLS  
 Chairman, Joint Legislative  
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## SUMMARY

In 1971, the Department of Parks and Recreation (department) entered into a concession contract with Bazaar del Mundo, Inc., (concessionaire) to construct, modify, and operate a Mexican-style shopping arcade in Old Town San Diego State Historic Park. Since then, the concession agreement has been amended twice. These amendments have, among other things, extended the contract period, required the construction of additional improvements, and revised the method by which rent due to the State is calculated. The contract's second amendment, effective February 1, 1973, allowed the concessionaire to offset against its rental payments the costs of certain improvements to concession facilities. We were asked to determine whether the concessionaire has made all rental payments to the State required by the contract.

For the first 15 months of its operation, the concessionaire paid the correct amount of rent. For the period subsequent to the effective date of the contract's second amendment, the amount of rent due to the State is in question. We were unable to determine whether the concessionaire has made all rental payments required by the contract primarily for two reasons. First, the cost of improvements that can be offset against rent is uncertain because there is no clear record of

agreement between the department and the concessionaire as to which improvement costs can be deducted from rental payments. Due in part to informal agreements that cannot be substantiated, some improvement costs appear to be in question.

Second, the amount of rent due is uncertain because the department and the concessionaire disagree on the meaning of "gross receipts." Rental payments are based, in part, upon a percentage of gross receipts. The department contends that the concessionaire should be including the gross receipts from subleased stores in calculating its rent. The concessionaire maintains that only the rent received from subleased stores should be included. As of November 30, 1981, the difference between these two interpretations could mean a difference of more than \$111,000 in the amount of rent eventually due to the State.

We have recommended that the department and the concessionaire formally amend the contract to clarify which improvement costs may be offset against rental payments and to specify whether the concessionaire is required to include sublessees' gross receipts in its calculation of its rent. Further, we have recommended that the department enforce certain contract provisions that would help determine which costs of future improvement projects can be offset against rent. The department and the concessionaire have currently

negotiated a contract amendment that, if signed, would eliminate the process of offsetting improvement costs against the concessionaire's rent after October 1, 1982.

## INTRODUCTION

In response to a request by the Joint Legislative Audit Committee, we have conducted an audit of Bazaar del Mundo, Inc., a concessionaire at Old Town San Diego State Historic Park, to determine whether this concessionaire has made all appropriate rental payments to the State. We contracted with a consultant, Jane E. Ritzinger, C.P.A., to perform a major portion of this audit. This study was conducted under the authority vested in the Auditor General by Sections 10527 through 10528 of the Government Code.

### Background

The California Public Resources Code authorizes the Department of Parks and Recreation (department) to contract with private entities for the construction, maintenance, and operation of concessions within state parks for the safety and convenience of the general public. Typical concessions include snack bars, gift shops, and restaurants. In 1981, the department had contracts with approximately 140 concessionaires to operate various concessions located within 66 state parks throughout the State.



The State Park and Recreation Commission classified Old Town San Diego as an Historic Park in 1968. The commission intended the park to reflect the Mexican and the American heritage of one of the first white settlements in California. The park was to be a "living, thriving village" representing the historical values of the mid-1800s. The State leased the first concessions within the park to former tenants, who continued businesses that existed before the State acquired the property. These businesses include an art gallery, a restaurant, and several gift shops. There are currently 16 concessions in Old Town San Diego State Historic Park.

In 1971, the department entered into a concession agreement with Bazaar del Mundo, Inc. (concessionaire), to construct, modify, and operate a Mexican-style shopping arcade in Old Town San Diego State Historic Park. Since then, the agreement has been amended twice. Among other things, the amendments extended the contract period, required the construction of additional improvements, and revised the method by which rent due to the State is calculated.

Bazaar del Mundo, Inc., currently operates a number of small shops and two restaurants in the arcade, as well as two restaurants outside the arcade. In addition, it subleases space to seven other entities, including a shop that is owned by the sole shareholder of Bazaar del Mundo, Inc.

## Scope and Methodology

Our review had two objectives. First, we sought to determine whether the concessionaire had made all rental payments to the department required under the contract as amended. Second, we were to provide specific information requested by the Legislature, including the concessionaire's gross receipts, the gross receipts of subleased stores, the rental income from subleases, and the rental payments to the State.\*

To accomplish these objectives, we interviewed representatives of the Department of Parks and Recreation and Bazaar del Mundo, Inc., in order to clarify each party's interpretation of the terms of the contract. We also reviewed correspondence files of the department's concessions unit and area office at Old Town San Diego State Historic Park. Our consultant obtained most of the financial data presented in this report from the department's audit office and from the concessionaire's accountant, Touche Ross & Co. The department's auditors reported on the concessionaire's gross receipts and capital expenditure costs for the period from

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\* Amendment No. 2 uses the terms "gross receipts" and "gross sales" interchangeably. To avoid confusion, this report will use the term "gross receipts" unless we are using a quotation which contains the phrase "gross sales."

February 1, 1973, to January 31, 1980. Our consultant reviewed the department's auditing procedures to determine the extent to which we could rely upon their data.

#### Audit Limitations

Our consultant was unable to verify fully the concessionaire's gross receipts because of the concessionaire's complex methods of recording sales and because of the time limitations imposed upon this study. The concessionaire's system of internal accounting control does not permit expeditious, independent testing. Our consultant reports that, in order to verify sales data, it would have been necessary to perform the duties of a full-time employee for numerous days in each year that was audited. We did not have sufficient time to perform these additional audit tests.

Our consultant also attempted to test the gross receipts of five of the concessionaire's sublessees. The gross receipts of these sublessees constitute 76 percent of the gross receipts of all sublessees for the period under audit. Of the five sublessees our consultant selected for review, only two were able to provide the necessary sales records within the time period allowed for this audit. Based on this information, our consultant was able to verify that one sublessee accurately reported its gross receipts to the concessionaire for 1980 and

1981. However, documentation for earlier years was not readily available. The other sublessee did not provide sufficient records to substantiate the amount of gross receipts reported. Consequently, our consultant was able to verify only the gross receipts of one of the concessionaire's sublessees for 1980 and 1981.

## AUDIT RESULTS

### THE AMOUNT OF RENT DUE TO THE STATE IS IN QUESTION

Our consultant was unable to determine whether Bazaar del Mundo, Inc., has made all rental payments to the Department of Parks and Recreation required under the contract as amended. Although the State received the correct amount of rent for the first 15 months of the concessionaire's operation (November 4, 1971, to January 31, 1973), the appropriate amount of rent due to the State for subsequent periods is in question.

With the implementation of the second amendment to the contract in February 1973, the amount of rent to be paid to the State was to be based upon a percentage of gross receipts minus the concessionaire's cost to make certain improvements to concession facilities. We found, however, that the concessionaire made many improvements beyond those specified in the written contract and that no clear record exists as to which of the added improvements may be deducted from the rent. In addition, the department and the concessionaire disagree about the meaning of "gross receipts." Therefore, the two major components of the rental payment computation, the cost of constructing improvements to concession facilities and the nature of gross receipts, have not been clearly established.

The amount of rent due to the State will vary depending upon how it is calculated. For example, according to the concessionaire's understanding of the formula for calculating rent, our consultant found that, as of November 30, 1981, the concessionaire had made all appropriate rental payments to the State. In addition, the concessionaire would be able to offset over \$499,000 against future rental payments. However, according to the department's audit office, the concessionaire had underpaid the State approximately \$332,000 as of January 31, 1980. In computing this amount, the department's audit office did not allow for certain verbal and written agreements between the concessionaire and the department and its employees.

Early Rental  
Payments Are Correct

For the first 15 months of operations (November 4, 1971, through January 31, 1973), the concessionaire paid the correct amount of rent to the State, \$28,494. During this period, the concessionaire was required to base its rent upon a percentage of gross receipts. Appendix C illustrates our consultant's rental calculations and includes the rental provisions specified by the contract.

The Second Amendment to the  
Contract Allows the  
Concessionaire to Offset  
the Cost of Specified Improvements

The contract's second amendment, effective February 1, 1973, significantly changed the method for computing rent. In essence, the amendment permits the concessionaire to deduct from its rent the cost of certain improvements made to the concession facilities. As of November 30, 1981, Bazaar del Mundo, Inc., had spent approximately \$1,100,000 on leasehold improvements. Of this amount, approximately \$995,000 was spent after February 1, 1973, the effective date of Amendment No. 2.

Specifically, the amendment required the concessionaire to establish an amortization account, the balance of which would determine the amount of rent owed to the State. (The specific contract language describing the rental payment computation process is provided in Appendix E.) Although this contract provision is vague and could have varying interpretations, the following briefly describes how the amortization account operates, as agreed upon by the

department and the concessionaire.\* The concessionaire must add to the account  $1\frac{1}{2}$  percent of the annual gross receipts less any rental payments (the minimum rental is \$3,600) and the excess, if any, of 2 percent of the annual gross receipts over the cost of advertising and promotion. The concessionaire shall deduct from the account the cost of constructing certain improvements to the concession facilities as specified in the contract. The concessionaire shall also deduct 8 percent of the previous year's ending balance in the amortization account if such balance is a negative amount.

Whenever the balance in the amortization account is positive, the concessionaire must pay that amount as rent to the State. When the account contains a negative balance, the concessionaire is required to pay only the minimum rental of \$300 per month. Appendix D demonstrates this arrangement, detailing the concessionaire's computation of rent from 1973 to 1981.

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\* One example of vagueness is the use of the term "amortization." Amortization is normally defined as the process of periodically offsetting a portion of an asset's cost against a business entity's income. In this instance, however, the concessionaire "amortizes" the cost of leasehold improvements by offsetting them against rental payments.



Allowable Improvement Costs  
Cannot Be Substantiated

We were unable to determine the cost of improvements made by the concessionaire that should be offset against the rent. The second amendment authorized the concessionaire to deduct from its rent the costs of three specific improvement projects. However, the concessionaire made additional improvements for which there is no clear record showing which of these improvements were authorized by the department to be included in the amortization account. In addition, the concessionaire's records generally do not permit the identification of costs associated with specific projects. Finally, neither the department nor the concessionaire followed certain procedures outlined in the contract that would have aided in assigning costs to specific projects.

The contract specifically authorizes the concessionaire to offset the costs of three improvement projects against rent. The first project involved the construction of park offices and an orientation center in a building called the "Bandini House." The second authorized project was the construction of a restaurant and a walkway at a structure known as "El Nopal." These two projects cost the concessionaire an estimated \$169,000. The third project was

the reconstruction of one of the historic buildings on Calhoun Street. This project was never undertaken by the concessionaire nor required by the State.

In addition to making two of the improvements specifically authorized in the contract, the concessionaire has made a number of other improvements. These improvements included installing a restaurant in the Bandini House, adding a service bar and expanding the dining area in the Casa de Pico, and remodeling a farmer's market (this facility was later converted to a restaurant now called Lino's).<sup>\*</sup> Further, the concessionaire added and subsequently expanded public restrooms and made numerous other improvements to the other shops and offices. As of November 30, 1981, the total cost of these added improvements was approximately \$826,000.

The contract states that the concessionaire must have written approval in advance by the department before making additional improvements to the concession facilities. The contract establishes specific procedures for obtaining the department's approval for such improvement plans. Under these

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<sup>\*</sup> The contract required the concessionaire to upgrade and expand the concession facilities in the Bandini House; the contract did not, however, specify what type of concession facilities were to be constructed.

procedures, the concessionaire is required to submit to the department the preliminary drawings, working drawings, and specifications for all improvement projects.

The department's architectural unit approved virtually all of the work done by the concessionaire, even though the department's files did not contain all the drawings and specifications required by the contract. In some cases, the department granted approval after the improvement project had already begun. In addition, representatives of the department's architectural unit stated that the concessionaire was probably given verbal approval to proceed with those projects for which no written approval was evident. Usually, verbal approvals were given for minor improvements such as changes made to retail shops within the arcade area.

Thus, the department's architectural unit apparently approved, either verbally or in writing, the construction of virtually all improvements made by the concessionaire. It is not clear, however, exactly which improvement projects in addition to those specified in the contract were intended by department officials to be included in the amortization account. In fact, department officials admit that the concessionaire probably construed approval by the architectural unit to mean that the concessionaire was authorized to deduct

the construction costs from its rent. The contract does not specify whether the cost of the added improvement projects can be included in the amortization account.

Our consultant found that various department officials informally authorized the concessionaire to deduct from its rent the cost of most of the additional improvement projects. In a letter to the concessionaire, dated February 1, 1980, the department's concessions unit acknowledges that at least some of the costs to construct the Bandini House restaurant were to be included in the amortization account. In addition, the manager of the concessions unit states that the concessionaire received verbal approval from various department representatives to offset the cost of many other improvement projects against its rent. These projects include the expansion of public restrooms, the remodeling of the Farmer's Market and its subsequent conversion into Lino's restaurant, the addition of the service bar and the expanded dining area at the Casa de Pico, and the installation of security grills on certain windows of the concession facilities.

There is some question about whether the concessionaire was granted approval to offset the costs of other improvement projects against rent. This uncertainty has

arisen because the concessionaire and the department disagree about which improvement projects are authorized for inclusion in the amortization account.

The concessionaire maintains that the costs of all permanent improvements can be offset against the rent. The manager of the concessions unit states, however, that such a blanket authorization of all improvements was not given. One area of disagreement, for example, concerns various permanent improvements made to the interior of the arcade. The manager of the concessions unit points out that while other department employees may have authorized these improvements, the department's files contain no record of such authorization. For example, the former supervisor of the concessions unit, who is now deceased, may have made some verbal agreements with the concessionaire.

In addition to not being able to substantiate specifically which improvement projects may have been authorized for rental offset, our consultant had difficulty identifying the costs attributed to the various projects. Except for the Bandini House restaurant, the concessionaire's accounting records do not separate the costs of the individual improvement projects. All other improvement costs are charged to a single leasehold-improvements account. Further, the

supporting records and invoices contain insufficient information to determine which costs are associated with which projects.

If the department and the concessionaire had followed some of the procedures established in the contract, the cost of projects may not be in dispute. The contract contains two provisions which, if followed, would have documented the date of completion of the various improvement projects. Paragraph 8 of the second amendment states, in part, the following: "Upon said completion, of each phase, Concessionaire shall file a Notice of Completion of Construction with State...." Similarly, paragraph 7 of the second amendment requires the concessionaire to provide certification by an architect that the construction of projects was substantially in accordance with the original plans and specifications.

Except for the Bandini House, such notices and certificates were never filed by the concessionaire. Furthermore, the State never enforced these requirements. Such documents would have identified separate projects, substantiated the construction, and established a date when costs should no longer be incurred for the project. If the concessionaire and the department had followed the specified

procedures, they could possibly have alleviated disagreements about which projects should have been included in the amortization account.

The contract also provides procedures for establishing the cost of projects, although these procedures are unrelated to the provisions pertaining to rent. The contract states the following:

...upon filing of Notice of Completion...or within 30 days of opening for business, whichever is earlier, Concessionaire will submit verified cost statements accompanied by substantiating invoices and bills of labor, material or any reasonable other construction costs, to State.... In the event costs are not filed by Concessionaire for each phase within the period above provided, State shall estimate said cost and serve the same on Concessionaire in the manner provided herein.

Generally, these procedures were not followed by the concessionaire nor enforced by the department. Although the purpose of these procedures was to establish the cost of improvements that would be paid to the concessionaire if the State chose to terminate the contract, the costs established by these procedures would, in our opinion, provide a valuable basis for determining the costs to be included in the amortization account.

The Meaning of "Gross Receipts" Is Disputed

The department and the concessionaire disagree about whether the gross receipts from subleased stores should be included in rental payment computations. Our consultant did not find conclusive evidence that would entirely support the interpretation of either the department or the concessionaire. The difference in interpretation will affect at least \$111,000 in the amortization account balance as of November 30, 1981.

The concession contract defines gross receipts as follows:

...all monies, property or any other thing of value received by Concessionaire through the operation of said concession or from any other business carried on or upon said premises or any portion thereof, or from any other use of said premises or any portion thereof by Concessionaire, without any deduction or deductions,...however, that the term "gross receipts" shall not include any sales or excise taxes imposed by any governmental entity and collected by Concessionaire.

The department maintains that because the amendments did not change this definition, the concessionaire should include the gross receipts from subleased stores in the percentage of rental payments that is added to the amortization



account. In addition, for the first year of operation under the terms of the original contract and the first amendment, the concessionaire in fact paid rent, in part, on sublessees' gross receipts.\*

The concessionaire maintains that it should exclude the gross receipts of the sublessees from its computation of rent and that only the rent received from sublessees should be included. The concessionaire points out that the contract defines gross receipts as "monies, property, or any other thing of value received by Concessionaire..." (emphasis added). The concessionaire states that the only thing of value it receives from the sublessees is their rental payment. In addition, the concessionaire points out that the original contract and its first amendment contained a separate rental rate percentage for sublessees' gross receipts after the concessionaire's first year of operation and that this language was omitted from the contract's second amendment.\*\*

The concessionaire has not, however, always reported its gross receipts in a manner that is consistent with its interpretation of the contract. The contract requires the

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\* The rental provisions of Amendment No. 1 are detailed in Appendix C.

\*\* The rental provisions of Amendment No. 2 are detailed in Appendix E.

concessionaire to report gross receipts to the department on both a monthly and a yearly basis. The report form supplied by the department and used by the concessionaire contains the following instruction: "Please enter here your sales or receipts by months for which percentage of gross sales are used to determine rent due the State of California." In all reports but those for 1973, the concessionaire included the sublessees' gross receipts. In 1973, the concessionaire's reports excluded the sublessees' gross receipts but also excluded any income from sublessees' rental payments. The concessionaire states that these reports were improperly completed and that the reports did not reflect its interpretation of the contract.

The difference between the two interpretations of the contract will make a significant difference in the amount of rent to be paid to the State. From February 1, 1973, the effective date of the second amendment, through November 30, 1981, the sublessees' gross receipts totaled approximately \$8,119,000, whereas sublessees paid only about \$713,000 in rent for the same period. The difference, \$7,406,000, multiplied by the  $1\frac{1}{2}$  percent rental rate equals a \$111,090 difference in the amount of percentage rent to be added to the amortization account. The amount of rent due to the State will vary accordingly because the amount of rent depends upon the balance in the amortization account. The actual difference in the amortization account balance will be even greater because the

8 percent to be deducted from the account will vary as the account balance varies. Further, since the contract requires the concessionaire to spend a minimum of 2 percent of annual gross receipts for advertising and promotion, the difference in the interpretation of the contract may affect the amounts added to the amortization account if the concessionaire fails to meet this requirement.

The Balance in the Amortization  
Account Is in Question

Because of the discrepancies and differences discussed in the preceding sections, the concessionaire and the department's internal auditor have considerably different views about the amount of rent that the concessionaire owes to the State. The concessionaire maintains that gross receipts exclude sublessees' sales and that the cost of all improvements made after February 1, 1973, should be applied to the amortization account. Thus, the concessionaire maintains that under this interpretation, no additional rent is due the State. Appendix D provides our consultant's calculation of rent due the State based on the concessionaire's interpretation of the contract.

The department's auditor reported on May 20, 1980, that the concessionaire owed the State approximately \$332,000 for the period from February 1, 1973, through January 31, 1980. In calculating this amount, the auditor included sublessees' gross receipts in computing the rental percentage and offset the rent only by the cost of converting the El Nopal building into a restaurant and remodeling the Bandini House for park offices. The department's auditor did not include in the amortization account the costs of constructing a walkway adjacent to the El Nopal building even though this project was authorized by the contract. Further, the auditor did not include the costs of any improvements that were authorized by informal agreement. According to the department auditor's interpretation, the amount of rent due the State would then be even greater as of November 30, 1981, because no additional improvements would have been deducted from the amortization account.

In order to compute an appropriate balance, the department and the concessionaire will need to settle their differences over the meaning of "gross receipts" and the number and scope of improvements that may be used to offset rent.

## CONCLUSION

Until the department and the concessionaire can settle certain contract disputes, jointly determine which improvement costs can be used to offset rent, and implement procedures to establish project costs, it will be virtually impossible to determine the amount of rent due to the State.

## RECOMMENDATION

To resolve contract disputes and clarify which improvement costs may be offset against rental payments, we recommend that the department and the concessionaire formally amend the concession contract as follows:

- Clarify the method for determining rent by defining such terms as "amortization," "8% capital recovery," and "improvements;"
- Identify the individual improvement projects constructed to date and the costs that the concessionaire is allowed to include in the amortization account;

- Designate within the department an individual or organizational unit having the sole authority to approve which costs of any future projects proposed by the concessionaire may be offset against rent;
- Require the concessionaire to establish separate accounts in its bookkeeping system for each improvement project approved for rental offset;
- Establish a method by which the department approves in advance those costs in an improvement project that will be allowed for rental offset;
- Require the concessionaire to report periodically the amortization account balance and the transactions occurring within the period; and
- Specify whether the concessionaire is required to include in its calculations of rent the gross receipts of its sublessees.

To ascertain that improvement projects are completed in accordance with approved plans and to substantiate the allowable costs of any current or future

projects, we recommend that the department follow the provisions of the contract that apply to the approval and completion of projects. Specifically, the contract provides for the following:

- The concessionaire's architect should provide certification that the construction of projects was substantially in accordance with the original plans and specifications;
- The concessionaire should file a Notice of Completion of Construction upon the completion of an approved project; and
- The concessionaire should submit cost statements accompanied by substantiating invoices and bills of labor, materials, or any other reasonable construction costs.

#### CORRECTIVE ACTION TAKEN

The department and the concessionaire have negotiated an amendment to the concession contract. When signed by both parties and approved by the appropriate state entities, the amendment will be effective retroactive to October 1, 1981. (The concessionaire has already signed this amendment.) Under the proposed amendments, the concessionaire's rent will be

4½ percent of gross receipts, which specifically include sublessees' gross receipts. For the period from October 1, 1981, to October 1, 1982, the concessionaire may offset the cost of improvements, as established under the prior contract, against one-half the rent, as long as these costs have not been previously offset. The proposed amendment establishes that the cost of improvements that can be offset against rent as of January 1, 1981, is \$427,000. After October 1, 1982, no further offset of costs will be allowed, and the concessionaire will be required to pay the full rent to the State. If this proposed amendment is adopted, neither the department nor the concessionaire will need to implement our recommendations.



OTHER INFORMATION  
REQUESTED BY THE LEGISLATURE

In addition to determining whether the concessionaire had made all the required rental payments, we were also asked to provide information on the gross receipts and rental payments of the concessionaire and its sublessees from the beginning of the contract through November 1981. Appendix A provides data on the gross receipts, and Appendix B contains the information on rental payments.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

Date: April 5, 1982

Staff: Steven L. Schutte, Audit Manager  
Allison G. Sprader

## DEPARTMENT OF PARKS AND RECREATION



(916) 445-2358

Mr. Thomas W. Hayes  
Auditor General  
660 "J" Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

Thank you for the opportunity to review your draft report, "The Amount of Rent Due to the State from Bazaar del Mundo, Inc., a Concessionaire at Old Town San Diego State Historic Park is in Question". It appears to me that your comments and conclusions regarding management of this contract by past administrations in this Department are essentially correct.

When I assumed the position of Director, I concluded that the basic problem with management of this concession was the diffusion of administration and approval authority among various employees within the Department. As you point out, that diffusion resulted in unclear accountability for monitoring the concessionaire's performance. To my mind, your key recommendation for management is at the top of page 23: "Designate within the department an individual or organizational unit having the sole authority to approve ...".

Secondly, and as we reported in our March 19, 1981 Report to the Legislature on this concession, Amendment No. 2, effective February 1, 1973, contains vague and inappropriate terms for payment of rent and set-off of concessionaire's construction costs against rental. I made renegotiation of that concession agreement my highest priority, and the renegotiated agreement will be presented to the Legislature during budget hearings this session.

To improve the accountability and effective management of the renegotiated contract, I have directed my staff to review all concessions agreement procedures through planning, the bid process, and management of concessions. My proposed correction of previous deficiencies in contract management will also be discussed with the Legislature during budget hearings.

Mr. Thomas W. Hayes  
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Again, thank you for the opportunity to discuss this report with your staff and to make comments and corrections prior to its publication. This opportunity was much appreciated and I think it led to a better, more factual report.

Sincerely,

  
Pete Dangermond, Jr.  
Director



# BAZAAR DEL MUNDO

2754 Calhoun Street  
San Diego, California 92110  
296-3161

March 29, 1982

Mr. Thomas W. Hayes  
Auditor General  
State of California  
669 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes:

We have reviewed the draft copy of the Auditor General's report of Bazaar del Mundo, Inc., concession agreement which was received by me March 23, 1982.

We believe that your staff and consultants have, in general, conducted a thorough review of the relationship between Bazaar del Mundo and the State of California Department of Parks and Recreation. In almost every instance, the principal questions presented in your report have been the subject of extensive discussion and review between ourselves and representatives of the State of California during the negotiating process for the amendment presently under review.

In our opinion, these questions have evolved because none of the employees of the State of California with whom we originally negotiated are now with the State government or responsible for the administration of this concession contract. We believe it is extremely important to recognize that the original contracts and the amendments under which we operated were drafted by the State of California and approved by all of the appropriate agencies in each instance prior to the execution.

In my opinion, as the individual responsible for making the major investment decisions and carrying out the day to day management responsibilities, there has never been any misunderstanding of the original intent of the contract, the incentives to be provided and the operating objectives.

In an attempt to resolve the questions that have been raised by the various State entities, I have during the course of negotiations acceded to the State's desire to increase their revenues and amend the existing agreement for purpose of clarification. Even though, in my opinion and that of my advisors, there is no fundamental need to do so. These extended negotiations were consummated last November to the satisfaction of the State's duly appointed representatives. The results of those negotiations were then embodied in a contract amendment drafted by the responsible State officials. Last year I executed that amendment and returned it to the State where it now apparently awaits the necessary Legislative approvals.

The reason that I am outlining these matters and request they be included in your report is that, in fact, all of the principal contractual questions that you have raised would be immediately resolved without

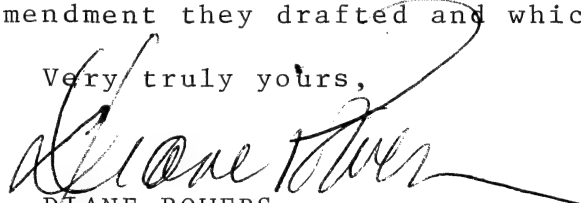
Thomas Hayes  
Page two  
March 29, 1982

further cost or delay and with substantial financial benefit to the State if the State executed the amendment.

The "Recommendations" made in your report are either resolved by the execution of the contract amendment and would no longer be necessary. Specifically, there would no longer be a question relating to the amortization account since there have been no additions to that account since November 1, 1981 and as an integral part of our negotiations relating to the increased rent payments, the Department staff and we agreed as to the amount remaining in that account. Further, the question as to which sales are included in gross receipts subject to rent payments would be resolved since the new amendment changes the present language to provide for the inclusion of our sales as well as those of our sublessees.

Your report substantiates the fact that all major actions we have undertaken were with the knowledge and consent of the Department of Parks & Recreation representatives. As your consultant found: "According to the concessionaire's understanding of the formula for calculating rent,... as of November 30, 1981, the concessionaire had made all appropriate rental payments to the State." In this light and in view of our previous comments and your staff audit, I believe it would be appropriate for you to recommend to the State that they proceed with the expeditious ratification of the contract amendment they drafted and which I signed.

Very truly yours,



DIANE POWERS  
Owner/Operator

DP/crf

P. S. As you know, we have signed an amendment to our contract after an extensive negotiation, which among other things, involved a resolution of the matters raised in your report. Attached you will find suggested language for inclusion in the report which we believe will more fully reflect the substance of the audit. In addition, I am concerned about the subtitle wording on the first page: "THE AMOUNT OF RENT DUE TO THE STATE FROM BAZAAR DEL MUNDO, INC., A CONCESSIONAIRE AT OLD TOWN SAN DIEGO STATE HISTORIC PARK, IS IN QUESTION." The last three words - "IS IN QUESTION" are slightly misleading and I would prefer a less controversial subtitle.

AUDITOR GENERAL COMMENT: The concessionaire suggests a number of wording changes to our report. We have not made the specific changes suggested because they either duplicate information already presented in our report or conflict with our study results.

SUGGESTED LANGUAGE FOR INCLUSION IN THE REPORT OF THE OFFICE OF  
THE AUDITOR GENERAL TO THE JOINT LEGISLATIVE COMMITTEE RE BAZAAR DEL MUNDO:

Summary

Page ii - the last paragraph should read:

"The concessionaire and the Department have, after extensive discussion, negotiated an amendment to the contract which, in addition to increasing the percentage rent, would resolve the questions of "gross receipts" and the amount of the balance in the amortization account.

This amendment has been signed by the concessionaire and delivered to the state."

Introduction

Page 4

Audit Limitations - add the following sentence to the end of the first paragraph:

"However, we have no reason to believe that the concessionaire's internal accounting controls are not adequate."

Page 6

Audit Results - The first sentence of the first paragraph should read:

"Because of the necessity to interpret contract terms, our consultant was unable to determine whether Bazaar del Mundo, Inc., has made all rental payments to the Department of Parks and Recreation required under the contract as amended."

Page 14

Audit Results - add the following sentence to the end of the first paragraph:

"The proposed contract amendment would resolve any such dispute."

continued...

Suggested Language for inclusion in the report of the office of the Auditor General to the Joint Legislative Committee RE Bazaar del Mundo

Page 22

Audit Results - CONCLUSION should read:

"Because of the differing interpretation of the contract terms we were unable to determine the rent due the state. Assuming the concessionaires interpretation of gross receipts is correct and assuming the amount in the amortization account is correct, the concessionaire owes no money to the state."

RECOMMENDATION should read:

"To resolve contract disputes and clarify which improvement costs may be offset against rental payments, we recommend that the department and the concessionaire formally amend the concession contract in generally the form negotiated and signed by the concessionaire; and:"

OMIT the following two paragraphs:

- "Clarify the method for determining rent by defining such terms as "amortization," "8% capital recovery," and "improvements;"
- "Identify the individual improvement projects constructed to date and the costs that the concessionaire is allowed to include in the amortization account;

Page 23

Audit Results - RECOMMENDATION continued

OMIT the following paragraph:

- "Specify whether the concessionaire is required to include in its calculations of rent the gross receipts of its sublessees."

Page 24

Audit Results - CORRECTIVE ACTION TAKEN should read:

"The department and the concessionaire have negotiated an amendment to the concession contract, which has been signed by the concessionaire, and which if signed by the State and approved by the appropriate state entities, will be effective as of October 1, 1981. Under the proposed amendment, the concessionaire's rent will be 4¼ percent of gross receipts, which specifically include sublessees gross receipts. For the period from October 1, 1981, to.."

BAZAAR DEL MUNDO, INC., AND SUBLESSEES  
SUMMARY OF GROSS RECEIPTS  
FOR THE PERIOD NOVEMBER 1971 THROUGH NOVEMBER 1981

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	Total
Antelline	\$ 14,085	\$ 54,287	\$ 62,892	\$ 67,824	\$ 86,768	\$ 55,673						\$ 341,529
Casa de Jollas				39,546	3,858							43,404
Design Center		14,502	57,484	64,310	71,465	104,515	\$ 172,106	\$ 181,010	\$ 199,421	\$ 220,649	\$ 223,854	1,309,316
Estudio de Ceramica		11,257	17,270	18,093	19,339	21,008	11,244					98,211
Pottery Maker							4,525	11,542	9,714	10,894	10,142	46,817
Farmers' Market	15,050	55,227										70,277
Geppettos	12,477	51,174	69,936	90,871	130,632	173,919	211,271	201,251	216,130	239,635	169,627	1,566,923
Gifted Hand	19,173	65,279	81,526	98,547	154,597	207,786	255,994	242,837	250,781	235,032	151,358	1,762,910
Gusterman's	4,448	33,105	39,898	6,745								84,196
Libros	6,317	26,906	4,826									38,049
La Panaderia	5,317	41,026	70,736	78,850	90,726	95,334	115,915	150,351	157,906	172,551	161,605	1,140,317
Plant Man		33,093	76,518	90,659	97,998	104,579	171,177	176,964	155,031	141,651	72,243	1,119,913
Ring Master					71,286	125,864	161,034	188,605	203,080	148,169	111,973	1,010,011
Whirling Logs	2,103	13,502	1,406									17,011
Other										2,362		2,362
Subtotal	\$ 78,970	\$ 399,358	\$ 482,492	\$ 555,445	\$ 726,669	\$ 888,678	\$ 1,103,266	\$ 1,152,560	\$ 1,192,063	\$ 1,170,943	\$ 900,802	\$ 8,651,246
Bazaar del Mundo	79,064	724,538	1,214,113	1,765,653	2,648,341	3,811,588	4,851,026	5,698,520	6,814,646	8,448,242	8,932,256	44,987,987
Total	\$ 158,034	\$ 1,123,896	\$ 1,696,605	\$ 2,321,098	\$ 3,375,010	\$ 4,700,266	\$ 5,954,292	\$ 6,851,080	\$ 8,006,709	\$ 9,619,185	\$ 9,833,058	\$ 53,639,233

APPENDIX A



BAZAAR DEL MUNDO, INC.  
RENT PAID BY BAZAAR DEL MUNDO AND RENT RECEIVED FROM SUBLESSEES  
FOR THE PERIOD NOVEMBER 1971 THROUGH NOVEMBER 1981

	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>Total</u>
Rent Paid to the State												
Bazaar del Mundo	\$3,161	\$23,730	\$12,083	\$ -0-	\$ 20	\$ 3,600	\$ 3,600	\$ 3,600	\$ 3,600	\$ 3,600	\$ 3,300	\$ 60,294
Rent Received by Bazaar del Mundo, Inc.												
Antelline	\$ 872	\$ 4,116	N/A	N/A	\$ 5,532	\$ 3,375						
Casa de Jollas					209							
Design Center		2,380	N/A	N/A	6,459	7,781	10,069	\$10,902	\$11,230	\$12,426	\$12,605	
Estudio de Ceramica	5	920	N/A	N/A	1,572	1,979						
Pottery Maker							1,518	1,355	1,335	1,469	1,150	
Farmers' Market	587	2,253										
Geppettos	888	4,011	N/A	N/A	9,324	15,610	20,797	17,752	21,193	24,748	14,903	
Gifted Hand	1,578	5,776	N/A	N/A	12,908	19,636	22,234	25,616	25,835	23,130	14,453	
Gusterman's	376	1,592	N/A	N/A								
Libros	505	2,147	N/A									
La Panaderia	435	3,400	N/A	N/A	7,462	8,454	11,348	15,035	15,791	17,790	14,760	
Plant Man		3,144	N/A	N/A	8,740	9,304	16,590	17,697	15,503	14,700	6,725	
Ring Master					4,778	9,639	15,369	17,745	18,375	14,269	10,432	
Whirling Logs	174	1,051	N/A									
Other									2,476	257		
Total received	\$5,420	\$30,790	\$39,182	\$44,727	\$56,984	\$75,778	\$97,925	\$106,102	\$111,738	\$108,789	\$75,028	\$752,463

N/A = not available

BAZAAR DEL MUNDO, INC.  
COMPUTATION OF RENT DUE TO THE STATE  
FOR THE PERIOD NOVEMBER 1971 THROUGH JANUARY 1973

When the concessionaire began operations in November 1971, the contract required the concessionaire to pay 2 percent of its annual gross receipts for the first year of operation. When the first amendment to the contract took effect on January 1, 1972, the concessionaire was required to pay rent according to the following formula.

For the first year of operation:

A minimum annual rental, the sum of three thousand dollars (\$3,000), payable monthly at the rate of two hundred fifty dollars (\$250) or the following percentages of annual gross receipts, whichever sum is greater:

- Two percent of annual gross receipts, except beer and wine; plus
- Five percent of annual gross receipts from beer and wine.

For the remaining period of the contract and after the expiration of the first year of operation noted above, as a minimum annual rental, the sum of three thousand six hundred dollars (\$3,600) payable at the rate of three hundred dollars (\$300) per month, or the following percentages, whichever sum is greater:

- On gross receipts from stores owned and operated by Concessionaire: 2 percent of the first \$200,000 of annual gross receipts, except beer and wine; plus 4 percent of all over \$200,000 of annual gross receipts, except beer and wine; plus 5 percent of annual gross receipts from beer and wine.
- On gross receipts from subleased stores: 2 percent of the first \$200,000 of annual gross receipts, except beer and wine; plus 4 percent of all over \$200,000 of annual gross receipts, except beer and wine; plus 5 percent of annual gross receipts from beer and wine.

The following table shows the computation of the concessionaire's rent from November 1971 through January 1973. (The second amendment to the contract became effective on February 1, 1973.)

CONCESSIONAIRE'S RENT  
FROM NOVEMBER 1971 THROUGH JANUARY 1973

	<u>Total Gross</u> <u>Receipts</u>	<u>Rent</u> <u>Payable</u>	<u>Rent</u> <u>Paid</u>	<u>Balance</u> <u>Due to</u> <u>the State</u>
<u>Original Contract</u> Nov. - Dec. 1971	\$ 158,034	\$ 3,161	\$ 3,161	\$ 0
<u>Amendment No. 1</u> Jan. 1972 - Jan. 1973	<u>1,199,695</u>	<u>25,333</u>	<u>25,333</u>	<u>\$ 0</u>
Total	<u><u>\$1,357,729</u></u>	<u><u>\$28,494</u></u>	<u><u>\$28,494</u></u>	<u><u>\$ 0</u></u>

BAZAAR DEL MUNDO, INC.  
COMPUTATION OF RENT DUE AND BALANCE IN THE AMORTIZATION ACCOUNT  
FOR THE PERIOD FEBRUARY 1973 THROUGH NOVEMBER 1981

APPENDIX D

NOTE: This computation is based upon the concessionaire's interpretation of the provisions of the contract. According to this interpretation, "gross receipts" excludes sublessees' gross receipts and includes rental income; and "leasehold improvements" includes all permanent improvements made subsequent to February 1, 1973.

Year	Total Gross Receipts	1.5 Percent of Gross Receipts	Less Rent Paid	Excess Amount	Less Leasehold Improvements	Less 8 Percent on Prior Year Balance	Amortization Account Balance	Additional Rent Due the State
1973	\$ 1,201,854	\$ 18,028	\$10,480 <sup>a</sup>	\$ 7,548	\$ 10,209	\$ -0-	\$ (2,661)	\$ -0-
1974	1,810,380	27,156	-0 <sup>a</sup>	27,156	74,105	-0 <sup>b</sup>	(49,610)	-0-
1975	2,705,325	40,580	20 <sup>a</sup>	40,560	107,588	3,969	(120,607)	-0-
1976	3,887,366	58,310	3,600	54,710	109,515	9,649	(185,061)	-0-
1977	4,948,951	74,234	3,600	70,634	134,008	14,805	(263,240)	-0-
1978	5,804,622	87,069	3,600	83,469	60,422	21,059	(261,252)	-0-
1979	6,926,384	103,896	3,600	100,296	195,486	20,900	(377,342)	-0-
1980	8,557,031	128,355	3,600	124,755	277,008	30,187	(559,782)	-0-
1981	9,007,284	135,109	3,300	131,809	26,347	44,783	(499,103)	-0-
Total	\$44,849,197	\$672,737	\$31,800	\$640,937	\$994,688	\$145,352		\$ -0-

<sup>a</sup> The concessionaire overpaid its rent in 1973. The department held this overpayment and did not require further rental payments from the concessionaire until December 1975.

<sup>b</sup> We did not include an amount for 1974 because the prior year balance in the amortization account represents only an overpayment of rent and not an expenditure for improvements.

BAZAAR DEL MUNDO, INC.  
SECOND AMENDMENT TO THE CONCESSION CONTRACT  
RENTAL PROVISIONS

APPENDIX E

Payments and Amortization: Commencing with the effective date of this Amendment No. 2, Concessionaire shall:

- a. Rent: Pay an annual rental to the State of \$3,600 payable monthly at the rate of \$300.
- b. Amortization: Concessionaire shall establish an amortization account based on an amount equal to 1.5 percent of annual gross sales less \$3,600 per annum, which is paid to State, and apply any excess amount toward the amortization of the improvements to the extent of the cost established in Paragraph 8 entitled "Completion of Improvements," computed on an 8 percent capital recovery basis.

In the event the facilities and improvements have not been amortized under this paragraph at the end of this contract, then at that time such facilities and improvements will become the property of the State and at no expense to the State.

When the improvements are fully amortized, then the full percentage of gross receipts stated above will be paid as additional rent directly to the State.

- c. Advertising and Promotion: In addition to the above, Concessionaire agrees to spend a minimum of 2 percent of annual gross sales for promotion and advertising. It is mutually acknowledged that such advertising and promotion causes persons to visit the Old Town San Diego State Historic Park, visit historical and interpretative facilities and the shops of other concessionaires. Further, the Concessionaire agrees to include in his advertisements announcements of special events, historical dates and celebrations, as requested by the State. Concessionaire's public relations department or counsel will assist in promoting the Old Town San Diego State Historic Park.

Concessionaire shall submit to State, no later than 45 days after the close of his business year, verified cost statements and invoices verifying the expenditures of said funds. In the event Concessionaire does not annually expend a minimum of 2 percent of his annual gross receipts, then Concessionaire shall add to the amortization account the difference between the actual expenditure and the amount generated by 2 percent of the annual gross receipts, or such amount will be paid directly to State.

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
Secretary of State  
State Controller  
State Treasurer  
Legislative Analyst  
Director of Finance  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
California State Department Heads  
Capitol Press Corps